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Low Inflation and Strong Auctions

While mortgage rates climbed in December, they have decreased during the first two weeks of January. A combination of factors was favorable for mortgage markets this week. Low inflation, weaker than expected economic growth data, and strong demand for the Treasury auctions all helped mortgage rates move a little lower.

One primary long-term concern for mortgage investors is that the enormous level of stimulus intended to boost the economy will lead to higher inflation. Inflation erodes the value of fixed income investments, so future inflation expectations are a major determinant of bond values, including mortgage-backed securities (MBS). Inflation has not been a factor in the short-term, however, as virtually all of the data in recent months has shown it to be low. This week, the Consumer Price Index (CPI), the most widely watched inflation indicator, showed that core inflation rose only 1.8% from one year ago. The Fed's comfort zone is for core inflation to rise at a 1.0% to 2.0% annual rate, and Fed forecasts are for low core inflation this year. Mortgage investors will be watching these levels closely, and any surprises down the road could push mortgage rates higher.

A second major long-term issue for mortgage investors is that the vast increase in the supply of government debt will exceed the demand. So far, both foreign and domestic demand has remained strong. This week's Treasury auctions saw very solid demand, particularly for the longer-term 10-yr and 30-yr securities, which are the most comparable to MBS. The cause for concern is that some important buyers, including China, have been hinting that they will reduce their Treasury purchases if the US doesn't display more fiscal discipline. If demand were to fall, then yields would need to rise to attract investors, which would not be good for mortgage rates.

More on Regulation X (The new GFE)

Other than the new three page form, there are some major changes on how lenders disclose certain fees. The biggest change is how brokers have to now disclose income earned from the lender they sent your loan to. In the past, these fees were never shown to the borrower except at the very end of the transaction on the HUD-1 Closing Statement. It would have been too logical for the government to simply mandate these fees be shown on the new GFE. Instead, they have to be disclosed as a credit to the consumer to offset inflated origination fees. Since Mortgage Bankers are exempt from showing their internal income streams under the new regulations, it would be easy for consumers to be misguided in thinking the over inflated origination fees are a worse choice when comparing two GFE's. On the new form, the most important cost to keeping mind is BOX A (Your Adjusted Origination Charges).

Another huge change is for GFE's for purchase transactions. Under the new rules, all escrow, title, conveyance taxes, surveys, and inspections must be shown as expenses to the buyer, regardless of what the sales contract states. This presents a huge problem for buyers, as it incorrectly states the required amount of funds a buyer must come into closing with. Lenders must now council buyers and tell them to disregard what the form says, and show them what the seller will be paying and subtract that from the bottom line.

And lastly, the fees shown for home inspections and other 3rd party fees are now often inflated. Rules governing the new GFE state that if the lender low-balls a fee, they must cover the difference at closing if the actual fee is higher. In order to avoid this, lenders are now over stating these fees, to avoid a potential loss of income. Buyers must now be sharper than ever when reviewing potential loan offers.

Events This Week:

Inflation Low

Retail Sales Fell

Trade Deficit Up

Manufacturing Mixed

Events Next Week:

Wed 1/20

PPI

Housing Starts

Thur 1/21

Philly Fed

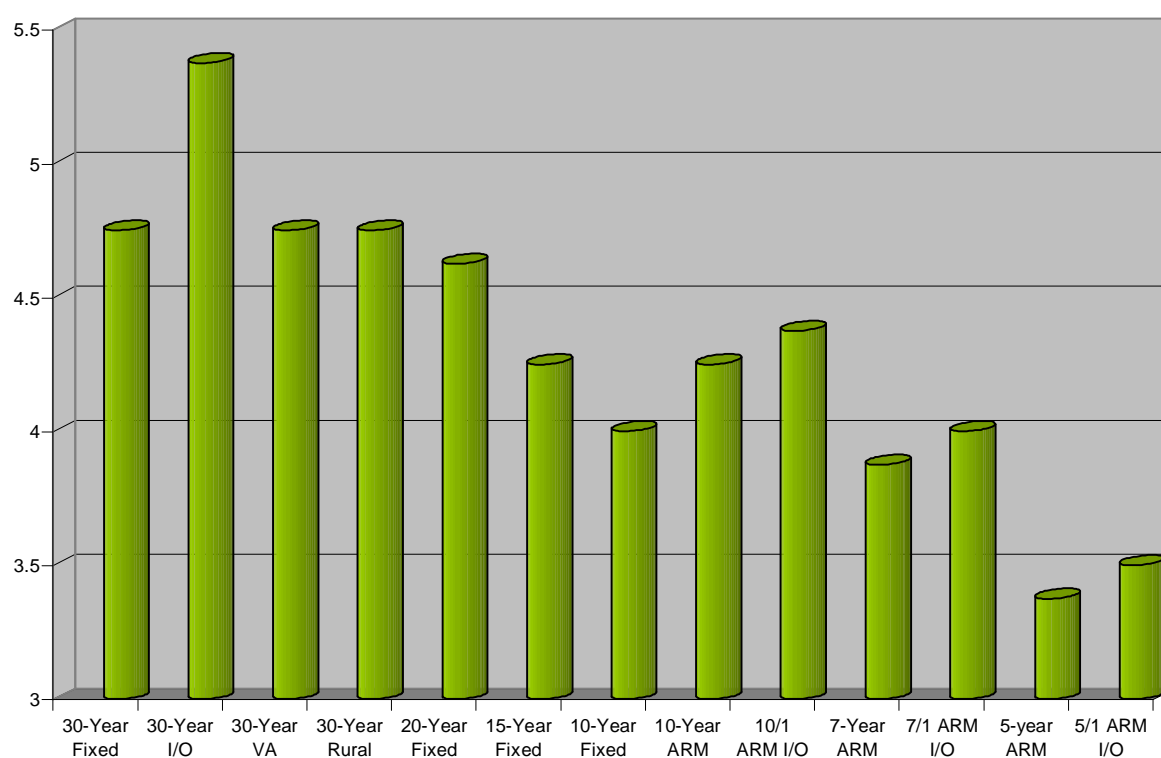
Leading Indicators

Treasury Announce.

Also Notable:

- The Fed's Beige Book reported "broader" improvement in economic activity
- The European Central Bank (ECB) made no change in rates
- The Dow stock index reached a 15-month high during the week
- The Fed purchased \$14 billion in agency MBS during the week ending 1/13

Conforming Rates as of 1/15/2010



Average 30 yr fixed rate:	
Last week:	-0.02%
This week:	-0.10%

Stocks (weekly):		
Dow:	10,600	+25
NASDAQ:	2,300	+10

Week Ahead

Next week, the Producer Price Index (PPI) will be released on Wednesday. PPI focuses on the increase in prices of "intermediate" goods used by companies to produce finished products. Housing Starts is also scheduled for Wednesday. Leading Indicators and the Philly Fed index will come out on Thursday. The Treasury will announce the size of upcoming auctions on Thursday as well. Mortgage markets will be closed on Monday for MLK Day.

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